THE UNIVERSITY OF THE WEST INDIES
CAVE HILL

EXAMINATIONS OF APRIL/MAY 2009.

CODE AND NAME OF COURSE: MGMT3053 - INTERNATIONAL FINANCIAL MANAGEMENT

DATE AND TIME: DURATION: 2 HOURS

INSTRUCTIONS TO CANDIDATES: This paper has 7 pages and 23 questions.

Section one is compulsory and has one question worth 20 marks. Section two has three questions from which candidates may answer any two questions. Each question is worth 25 marks.

SECTION 1

1. Which of the following theories suggests that firms seek to penetrate new markets over time?

   A) theory of comparative advantage.
   B) imperfect markets theory.
   C) product cycle theory.
   D) none of these.

2. Which of the following is *not* a way in which agency problems can be reduced through corporate control?

   A) executive compensation.
   B) threat of hostile takeover.
   C) acquisition of a foreign subsidiary.
   D) monitoring by large shareholders.

3. A weak home currency may not be a perfect solution to correct a balance of trade deficit because:

   A) it reduces the prices of imports paid by local companies.
   B) it increases the prices of exports by local companies.
   C) it prevents international trade transactions from being prearranged.
   D) foreign companies may reduce the prices of their products to stay competitive.

TURN OVER

4. Which of the following is *not* a factor that affects the bid/ask spread?

   A) Order costs
   B) Inventory costs
   C) Volume
   D) None of the above

5. Which of the following is *not* true with respect to spot market liquidity?

   A) The more willing buyers and sellers there are, the more liquid a market is.
   B) The spot markets for heavily traded currencies such as the Japanese yen are very liquid.
   C) A currency's liquidity affects the ease with which an MNC can obtain or sell that currency.
   D) If a currency is illiquid, an MNC is typically able to quickly purchase that currency at a reasonable exchange rate.

6. When the "real" interest rate is relatively low in a given country, then the currency of that country is typically expected to be:

   A) weak, since the country's quoted interest rate would be high relative to the inflation rate.
   B) strong, since the country's quoted interest rate would be low relative to the inflation rate.
   C) strong, since the country's quoted interest rate would be high relative to the inflation rate.
   D) weak, since the country's quoted interest rate would be low relative to the inflation rate.

7. Baylor Bank believes the New Zealand dollar will appreciate over the next five days from \$.48 to \$.50. The following annual interest rates apply:

Currency	Lending Rate	Borrowing Rate
Dollars	7.10%	7.50%
New Zealand dollar (NZ$)	6.80%	7.25%

Baylor Bank has the capacity to borrow either NZ\$10 million or \$5 million. If Baylor Bank's forecast if correct, what will its dollar profit be from speculation over the five-day period (assuming it does not use any of its existing consumer deposits to capitalize on its expectations)?

   A) \$521,325.
   B) \$500,520.
   C) \$104,262.
   D) \$413,419.
   E) \$208,044.

TURN OVER

8. The equilibrium exchange rate of pounds is \$1.70. At an exchange rate of \$1.72 per pound:

   A) Demand for pounds would exceed the supply of pounds for sale and there would be a shortage of pounds in the foreign exchange market.
   B) Demand for pounds would be less than the supply of pounds for sale and there would be a shortage of pounds in the foreign exchange market.
   C) Demand for pounds would exceed the supply of pounds for sale and there would be a surplus of pounds in the foreign exchange market.
   D) Demand for pounds would be less than the supply of pounds for sale and there would be a surplus of pounds in the foreign exchange market.
   E) Demand for pounds would be equal to the supply of pounds for sale and there would be a shortage of pounds in the foreign exchange market.

9. Kalons, Inc. is a U.S.-based MNC that frequently imports raw materials from Canada. Kalons is typically invoiced for these goods in Canadian dollars and is concerned that the Canadian dollar will appreciate in the near future. Which of the following is *not* an appropriate hedging technique under these circumstances?

   A) purchase Canadian dollars forward.
   B) purchase Canadian dollar futures contracts.
   C) purchase Canadian dollar put options.
   D) purchase Canadian dollar call options.

10. The 90-day forward rate for the euro is \$1.07, while the current spot rate of the euro is \$1.05. What is the annualized forward premium or discount of the euro?

   A) 1.9 percent discount.
   B) 1.9 percent premium.
   C) 7.6 percent premium.
   D) 7.6 percent discount.

11. Thornton, Inc. needs to invest five million Nepalese rupees in its Nepalese subsidiary to support local operations. Thornton would like its subsidiary to repay the rupees in one year. Thornton would like to engage in a swap transaction. Thus, Thornton would:

   A) convert the rupees to dollars in the spot market today and convert rupees to dollars in one year at today's forward rate.
   b) convert the dollars to rupees in the spot market today and convert dollars to rupees in one year at the prevailing spot rate.
   C) convert the dollars to rupees in the spot market today and convert rupees to dollars in one year at today's forward rate.
   D) convert the dollars to rupees in the spot market today and convert rupees to dollars in one year at the prevailing spot rate.

TURN OVER

12. Currency options sold through an options exchange:

    A) contain a commitment to the owner, and are standardized.
    B) contain a commitment to the owner, and can be tailored to the desire of the owner.
    C) contain a right but not a commitment to the owner, and can be tailored to the desire of the owner.
    D) contain a right but not a commitment to the owner, and are standardized.

13. A put option on British pounds has a strike (exercise) price of \$1.48. The present exchange rate is \$1.55. This put option can be referred to as:

    A) in the money.
    B) out of the money.
    C) at the money.
    D) at a discount.

14. Carl is an option writer. In anticipation of a depreciation of the British pound from its current level of \$1.50 to \$1.45, he has written a call option with an exercise price of \$1.51 and a premium of \$.02. If the spot rate at the option's maturity turns out to be \$1.54, what is Carl's profit or loss per unit (assuming the buyer of the option acts rationally)?

    A) –\$0.01.
    B) \$0.01.
    C) –\$0.04.
    D) \$0.04.
    E) –\$0.03.

15. Which of the following forecasting techniques would *best* represent the use of today's forward exchange rate to forecast the future exchange rate?

    A) fundamental forecasting.
    B) market-based forecasting.
    C) technical forecasting.
    D) mixed forecasting.

16. Economic exposure refers to:

    A) the exposure of a firm's ongoing international transactions to exchange rate fluctuations.
    B) the exposure of a firm's local currency value to transactions between foreign exchange traders.
    C) the exposure of a firm's financial statements to exchange rate fluctuations.
    D) the exposure of a firm's cash flows to exchange rate fluctuations.
    E) the exposure of a country's economy (specifically GNP) to exchange rate fluctuations.

TURN OVER

17. Assume zero transaction costs. If the 180-day forward rate is an accurate estimate of the spot rate 180 days from now, then the real cost of hedging receivables will be:

A) positive.
B) negative.
C) positive if the forward rate exhibits a premium, and negative if the forward rate exhibits a discount.
D) zero.

18. When a firm analyzes the feasibility of a project, it should consider:

A) the variability of the project's cash flow.
B) the correlation of the project's cash flow relative to the prevailing cash flows of the MNC.
C) both of these.
D) none of these.

19. Which of the following is *not* an advantage of international acquisitions over the establishment of a new subsidiary?

A) the firm can immediately expand its international business.
B) Y the firm benefits from existing customer relationships.
C) international acquisitions are generally cheaper than the establishment of a new subsidiary.
D) an international acquisition typically generates quicker and larger cash flows than the establishment of a new subsidiary.
E) All of these are advantages of international acquisitions.

20. An argument for MNCs to have a debt-intensive capital structure is:

A) they are well diversified.
B) foreign government tax rules may change over time.
C) exposure to exchange rate fluctuations.
D) exposure to fund blockage.

TURN OVER

SECTION 2

1. a) The U.S. three-month interest rate (unannualized) is 1%. The European three-month interest rate (unannualized) is 4%. Interest rate parity exists. The expected inflation over this period is 5% in the U.S. and 2% in Europe. A call option with a three-month expiration date on European dollars is available for a premium of $.02 and a strike price of $.64. The spot rate of the European dollar is $.65. Assume that you believe in purchasing power parity.

i) Determine the dollar amount of your profit or loss from buying a call option contract specifying Euro100,000. **(4 marks)**

ii) Determine the dollar amount of your profit or loss from buying a futures contract specifying Euro 100,000. **(3 marks)**

b) The one-year interest rate in Singapore is 11 percent. The one-year interest rate in the U.S. is 6 percent. The spot rate of the Singapore dollar (S$) is $.50 and the forward rate of the S$ is $.46. Assume zero transactions costs.

i) With reference to the theory of interest rate parity, discuss how a U.S firm can benefit from investing funds in Singapore using covered interest arbitrage? **(6 marks)**

ii) Discuss how a Singapore subsidiary can benefit from investing funds in the U.S.? **(4 marks)**

c) Compare and contrast the theories of Interest Rate Parity, Purchasing Power Parity and the International Fisher effect. **(8 marks)**

2) a) Your employer, a large MNC, has asked you to assess its transaction exposure. Its projected cash flows are as follows for the next year:

Currency	Total Inflow	Total Outflow	Current Exchange Rate in U.S. Dollars
Danish krone (DK)	DK50,000,000	DK40,000,000	$.15
British pound (£)	£2,000,000	£1,000,000	$1.50

Assume that the movements in the Danish krone and the pound are highly correlated.

i) Provide your assessment as to your firm's degree of transaction exposure (as to whether the exposure is high or low). Substantiate your answer. **(5 marks)**

ii) Would the exposure be any different if there was a negative correlation between these two currencies? Explain. **(3 marks)**

TURN OVER

Question 2 (cont'd)

b) Many schools of thought exist as to the relevance of exchange rate risk. The Multinational Corporation's treatment of exchange rate risk is a result of their thoughts on exchange rate risk. Discuss these various thoughts surrounding exchange rate risks, and the MNC's response to these arguments. (10 marks)

c) What factors influence an MNC's degree of transaction exposure? For each factor, explain the desirable characteristics that would reduce this exposure. (7 marks)

3) a) Assume the following options are currently available for British pounds (£):

- Call option premium on British pounds = $.04 per unit
- Put option premium on British pounds = $.03 per unit
- Call option strike price = $1.56
- Put option strike price = $1.53
- One option contract represents £31,250.

A speculator is thinking of making a profit on the movement in the pound's exchange rate, but currently the pound is fluctuating widely in doth directions.

i) What type of derivative should the speculator enter into? Explain. (2 marks)

ii) Construct a contingency graph representing the speculator's expected payoff on his chosen type of derivative (in a. above). (5 marks)

iii) If the spot price of the pound at option expiration is $1.55, what is the total profit or loss to the speculator? (3 marks)

b) Explain the difference between indirect and direct intervention by a country's central bank. Which type of intervention is likely to have a stronger impact on an actively traded currency? Explain. (7 marks)

c) Compare the floating and fixed exchange rate systems. What are some of the advantages and disadvantages of having a floating exchange rate system? (8 marks)

END OF QUESTION PAPER